Supreme Court, U.S.
FILED
JAN 27 2004
OFFICE OF THE CLERK

(2)

No. 03-751

In the Supreme Court of the United States

RICHARD AND MARY ROES, NOS. 2, 7, 8, 12 AND 21,
PETITIONERS

v.

UNITED STATES OF AMERICA AND BDO SEIDMAN, LLP

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

THEODORE B. OLSON
Solicitor General
Counsel of Record
EILEEN J. O'CONNOR
Assistant Attorney General
FRANK P. CIHLAR
KENNETH W. ROSENBERG
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether, in an action to enforce internal revenue summonses that had been issued to investigate possible illegalities in the promotion of tax shelter schemes by an accounting firm, the identity of individuals who participated in those schemes is privileged from disclosure under Section 7525 of the Internal Revenue Code, 26 U.S.C. 7525.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutory provisions involved	2
Statement	2
Argument	10
Conclusion	15
Appendix	1a

TABLE OF AUTHORITIES

Cases:

Grand Jury Proceeding (Cherney), In re, 898 F.2d 565 (7th Cir. 1990)	8, 11
Tillotson v. *Boughner*, 350 F.2d 663 (7th Cir. 1965)	8, 11, 13
United States v. *BDO Seidman, LLP*:	
225 F. Supp. 2d 918 (N.D. Ill. 2002)	4
345 F.3d 465 (7th Cir. 2003)	10
No. 02 C 4822, 2003 WL 932365 (N.D. Ill. Feb. 5, 2003)	6
United States v. *Liebman*, 742 F.2d 807 (3d Cir. 1984)	10, 12

Statutes and regulations and rule:

Internal Revenue Code (26 U.S.C.):	
§ 6111	2, 7, 14, 1a-7a
§ 6111(a)	2, 14, 15, 1a
§ 6112	2, 7, 14-15, 7a-9a
§ 6112(a)	2, 7a
§ 6112(b)	2, 8a
§ 6707	2, 9a-11a
§ 6708	2, 11a
§ 7525	2, 4-5, 6, 7, 15, 12a-13a
§ 7602	3
§ 7604	3

Regulations and rule—Continued: Page

26 C.F.R.:
Section 301.611-1T Q&A-17(b) (Temp. Reg.) 15
Section 301.6112-1(e)(3)(i) 15
Section 301.6112-1(g)(2)(i) 15
Fed. R. Civ. P. 24(a)(2) 4

Miscellaneous:

T.D. 9046, 68 Fed. Reg. (2003):
p. 10,161 15
p. 10,163 15

In the Supreme Court of the United States

No. 03-751

RICHARD AND MARY ROES, NOS. 2, 7, 8, 12 AND 21, PETITIONERS

v.

UNITED STATES OF AMERICA AND BDO SEIDMAN, LLP

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-17) is reported at 337 F.3d 802. A prior order of the court of appeals that had remanded the case for further proceedings is unofficially reported at 91 A.F.T.R.2d 2003-1651. The opinion of the district court on remand from the initial order of the court of appeals is unofficially reported at 91 A.F.T.R.2d 2003-1016 and 2003 WL 932365. The initial order of the district court (Pet. App. 19) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 23, 2003. A petition for rehearing en banc was

denied on August 26, 2003. Pet. App. 20. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 6111, 6112, 6707, 6708, and 7525 of the Internal Revenue Code, 26 U.S.C. 6111, 6112, 6707, 6708, and 7525, are set forth in the Appendix, *infra*, 1a-13a.

STATEMENT

1. Section 6111(a) of the Internal Revenue Code, 26 U.S.C. 6111(a), requires the organizers of certain tax shelters to register the shelters with the Service. Any tax shelter that must be registered under Section 6111(a), and any "arrangement which is of a type which the Secretary determines by regulations as having a potential for tax avoidance or evasion," is deemed to be "potentially abusive." 26 U.S.C. 6112(b). The organizers and sellers of such potentially abusive tax shelters must keep a list that identifies each person to whom an interest in the tax shelter was sold. 26 U.S.C. 6112(a). Penalties may be imposed for any failure to comply with the registration and listing requirements of Sections 6111 and 6112. See 26 U.S.C. 6707, 6708.

2. In September 2000, the Internal Revenue Service received information that suggested that BDO Seidman, a public accounting and consulting firm, was promoting potentially abusive tax shelters without complying with the registration and list-keeping requirements for organizers and sellers of tax shelters. The Service issued a series of summonses to BDO Seidman that identified twenty types of such tax shelter transactions in which it suspected that the firm's clients had invested.[1] Pet. App. 3. These summonses were issued

[1] According to the declaration of the IRS agent who issued the summonses, information the IRS had received both from an

under the authority provided to the agency by Section 7602 of the Internal Revenue Code to "examine any books, papers, records, or other data which may be relevant or material to" an inquiry or examination to determine the correctness of any return or the liability of any party for a tax imposed by the Code. 26 U.S.C. 7602.

The summonses issued by the Service required production of documents and testimony relating to the identified transactions and also sought information about clients of BDO Seidman who invested in the identified tax shelters. In particular, the summonses demand the production of documents in the possession of BDO Seidman that identify the investors in the transactions, the date on which those investors acquired an interest, and all tax shelter registrations filed and investor lists prepared with respect to the transactions. Pet. App. 3-4.

3. In July 2002, after BDO Seidman failed to produce the specified documents, the Service petitioned the district court for enforcement of the summonses pursuant to Section 7604 of the Code, 26 U.S.C. 7604. The accounting firm opposed enforcement on the grounds that the investigation lacked a legitimate purpose, that the summonses were overbroad and issued in bad faith, and that the information sought was already in the possession of the Service and was not relevant to its investigation. BDO Seidman also claimed that some of the summoned information was protected from disclosure by the attorney-client privilege, the work product

---

informant and from seven different investors indicated that BDO had been promoting potentially abusive tax shelters. C.A. Supp. App. 19-20.

doctrine, and the confidentiality privilege of Section 7525 of the Internal Revenue Code, 26 U.S.C. 7525.

In October 2002, the district court ruled that the Service had met its burden of showing that it issued the summonses in good faith. The court further concluded that the accounting firm had failed to show that enforcement of the summonses would constitute an abuse of process. *United States* v. *BDO Seidman, LLP*, 225 F. Supp. 2d 918, 920 (N.D. Ill. 2002). The district court then ordered BDO Seidman to produce, on or before November 4, 2002, all responsive documents except those that the accounting firm had listed on privilege logs and submitted to the court for *in camera* review. Pet. App. 4.

4. Based on the court's order, BDO Seidman informed its clients that it intended to produce responsive documents not previously submitted for the court's *in camera* inspection that reveal the identities of the BDO clients who invested in one or more of the 20 types of tax shelters identified in the summonses. In response to that notification, two sets of unidentified taxpayers (hereinafter referred to collectively as "the Roes" or "petitioners") filed motions to intervene in the enforcement proceedings pursuant to Federal Rule of Civil Procedure 24(a)(2). In their intervention applications, the Roes asserted that they are clients of BDO Seidman who sought confidential advice regarding the potential tax effects of certain proposed financial transactions. They argued that the documents that reveal their identities are privileged under 26 U.S.C. 7525, which generally provides that (*ibid.*):

> [w]ith respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney

> shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

The Roes claimed that their interests in confidentiality were not adequately represented by BDO Seidman in this case. The Roes conceded that the documents contain no privileged communications apart from the asserted confidentiality of their identities as BDO clients who invested in at least one of the 20 types of tax shelters described in the summonses. Pet. App. 5.

After a hearing, the district court denied the Roes' emergency motions to intervene. The court concluded that information on the disputed records that relates to the client's identity falls outside the scope of the Section 7525 privilege. The district court also concluded that the Roes had failed to establish a likelihood of success on the merits on an appeal and therefore denied the Roes' motion for a stay of the enforcement order. Pet. App. 5.

5. The Roes filed timely notices of appeal from the denial of their motions to intervene. They requested the court of appeals to stay the production of the documents for which they had asserted a confidentiality privilege in the district court. The court of appeals granted a temporary stay and also remanded the case to the district court for the limited purpose of entering more extensive findings regarding the documents for which the Roes claimed a privilege. Pet. App. 5-6.

6. On the remand ordered by the court of appeals, the district court directed counsel to submit a subset of the documents with information identifying the Roes for an *in camera* inspection. Upon reviewing all

confidentiality agreements, consulting agreements and engagement letters entered into between BDO and the Roes, the court determined that the identities of at least 55 of the intervenor-applicants were not subject to privilege under Section 7525. The court noted that many of the confidentiality agreements reflect that the particular Roes had engaged BDO's services for the purpose of preparing income tax returns. In addition, several consulting agreements contained a "No Warranty" provision, which states that "BDO's Services hereunder do not include * * * any legal and/or tax opinions regarding any strategies that may be implemented." *United States* v. *BDO Seidman, LLP*, No. 02 C 4822, 2003 WL 932365, at *3 (N.D. Ill. Feb. 5, 2003). The court concluded that this language indicates that the relationship between BDO Seidman and the Roes was not always that of tax advisor-client and that their communications were therefore not subject to the Section 7525 privilege. *Id.* at **3-4. The district court found that 133 of the documents it had reviewed established that BDO's communications with 55 Roes had not been for the purpose of providing tax advice and were therefore not privileged. The court further concluded that 28 of the documents were generated for the purpose of preparing tax returns, which is not a privileged category of communication. *Id.* at *2. Finally, with respect to 30 unidentified clients who sought intervention, the court was unable to make findings because no confidentiality agreements, consulting agreements or engagement letters had been produced on their behalf. Pet. App. 6-7.

7. Upon consideration of the findings made by the district court on remand, the court of appeals affirmed the denial of intervention. Pet. App. 1-17. The court of appeals noted that, in order to intervene, the Roes had

to establish that they had "a legally protectable interest in preventing the disclosure of the documents that would reveal their identities as individuals who sought BDO's advice regarding tax shelters." Pet. App. 8. The court emphasized that the provisions that require organizers of tax shelters to register the shelters with the IRS and to keep lists of the investors in those shelters (26 U.S.C. 6111, 6112) were enacted by Congress "for the purpose of providing the IRS with means to better monitor tax shelters, and, consequently, to deter abusive tax shelters that can adversely impact public revenues." Pet. App. 9 (citation omitted). The court stressed that the power to issue administrative summonses is "vital to the efficacy of the federal tax system" and "provides the IRS with great latitude to verify compliance with these tax shelter registration and list-keeping provisions." Pet. App. 10, 11.

The court pointed out that the scope of the statutory privilege for communications between a taxpayer and a tax practitioner (26 U.S.C. 7525) is determined by reference to the common law protections of confidential attorney-client communications. Pet. App. 12. Because the attorney-client privilege protects confidential *communications* between a client and his lawyer, the court noted that "ordinarily the identity of a client does not come within the privilege." Pet. App. 14. Only a limited exception to that rule exists: "the identity of a client may be privileged in the rare circumstance when so much of an actual confidential communication has been disclosed already that merely identifying the client will effectively disclose that communication." *Ibid.* (citations omitted).

The Roes claimed that this case falls within that limited exception, based on decisions holding that the attorney-client privilege applies when disclosure of

client identities would reveal the content of a confidential communication, such as *In re Grand Jury Proceeding (Cherney)*, 898 F.2d 565, 567 (7th Cir. 1990), and *Tillotson* v. *Boughner*, 350 F.2d 663, 666 (7th Cir. 1965). The court of appeals found those cases to be inapposite (Pet. App. 16-17):

> The [Roes] have not established that a confidential communication will be disclosed if their identities are revealed in response to the summonses. Disclosure of the identities of the [Roes] will disclose to the IRS that the [Roes] participated in one of the 20 types of tax shelters described in its summonses. It is less than clear, however, as to what motive, or other confidential communication of tax advice, can be inferred from that information alone. Compared to the situations in the *Tillotson* and *Cherney* cases, where the Government already knew much about the substance of the communications between the attorney and his unidentified client, in this case the IRS knows relatively little about the interactions between BDO and the [Roes], the nature of their relationship, or the substance of their conversations. Moreover, the [Roes] concede that the documents that BDO intends to produce in response to the summonses are not subject to any other independent claim of privilege beyond the [Roes'] assertion of privilege as to identity.

The court of appeals also emphasized that the policies that underlie the specific disclosure requirements of the tax shelter enforcement statutes preclude application of a privilege in the context of this case (Pet. App. 16-17):

> More fundamentally, the [Roes'] participation in potentially abusive tax shelters is information ordinar-

> ily subject to full disclosure under the federal tax law. *See* 26 U.S.C. §§ 6111, 6112. Congress has determined that tax shelters are subject to special scrutiny, and anyone who organizes or sells an interest in tax shelters is required, pursuant to I.R.C. § 6112, to maintain a list identifying each person to whom such an interest was sold. This list-keeping provision precludes the [Roes] from establishing an *expectation of confidentiality* in their communications with BDO, an essential element of the attorney-client privilege and, by extension, the § 7525 privilege. At the time that the [Roes] communicated their interest in participating in tax shelters that BDO organized or sold, the [Roes] should have known that BDO was obligated to disclose the identity of clients engaging in such financial transactions. Because the [Roes] cannot credibly argue that they expected that their participation in such transactions would not be disclosed, they cannot now establish that the documents responsive to the summonses, which do not contain any tax advice, reveal a *confidential* communication.

The court of appeals agreed with the district court that (i) the Roes had failed to establish a colorable claim of privilege under 26 U.S.C. 7525 and (ii) the Roes therefore had failed to establish a legally protectable interest in preventing the disclosure of the documents revealing their identities that would warrant their intervention in this case. Pet. App. 17.

8. The Roes moved to stay the mandate of the court of appeals pending consideration by this Court of their petition for a writ for certiorari. In denying that motion, the court of appeals stated that, "[a]s demonstrated by the panel's opinion, its holding does not

conflict with any Supreme Court authority or with any authority from other circuits." *United States* v. *BDO Seidman*, 345 F.3d 465, 466 (7th Cir. 2003).

The Roes then applied to this Court for a stay of the mandate of the court of appeals, which was denied by this Court on September 29, 2003 (No. 03-A299). The mandate of the court of appeals therefore issued on October 3, 2003. BDO Seidman has now complied with the enforcement order and produced the documents that disclose the identities of petitioners in the various tax shelter schemes under investigation.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioners err in claiming (Pet. 5-9) that the decision of the court of appeals "is in direct conflict" with *United States* v. *Liebman*, 742 F.2d 807 (3d Cir. 1984). In *Liebman*, the Internal Revenue Service issued a summons to a law firm seeking to obtain the identities of clients who had paid fees to the firm in connection with the purchase of interests in real estate partnerships. The Service was concerned that the clients might have erroneously claimed deductions for these fees. The court of appeals noted the settled rule that "absent unusual circumstances the identity of the client does not come within the attorney-client privilege," and that such "unusual circumstances" have been found to exist when "so much of the actual attorney-client communication has already been disclosed that identifying the client amounts to full disclosure of the communication." 742 F.2d at 809 (citations omitted). The court concluded in *Liebman* that the attorney-client privilege

applied under the "unusual circumstances" presented in that case (*ibid.*; citation and internal quotation marks omitted):

> If the summons merely requested the names of clients who paid fees, the information would not be protected by the attorney-client privilege. However, the summons is more specific. The affidavit of the IRS agent supporting the request for the summons not only identifies the subject matter of the attorney-client communication, but also describes its substance. That is, the affidavit does more than identify the communications as relating to the deductibility of legal fees paid to Liebman & Flaster in connection with the acquisition of a real estate partnership interest, App. at 116a-121a. It goes on to reveal the content of the communication, namely that "taxpayers . . . were advised by Liebman & Flaster that the fee was deductible for income tax purposes." App. at 117a. Thus, this case falls within the situation where so much of the actual communication had already been established, that to disclose the client's name would disclose the essence of a confidential communication.

In the present case, the court of appeals applied the same legal principles applied in *Liebman*. The court noted that, as a "limited exception" to the general rule of disclosure, "the identity of a client may be privileged in the rare circumstance when so much of an actual confidential communication has been disclosed already that merely identifying the client will effectively disclose that communication." Pet. App. 14 (citing, *e.g.*, *In re Grand Jury Proceeding (Cherney)*, 898 F.2d 565, 567 (7th Cir. 1990), and *Tillotson* v. *Boughner*, 350 F.2d 663, 666 (7th Cir. 1965)). The court explained that the privi-

lege attaches in such circumstances "[b]ecause revealing the taxpayer's identity would also reveal the content of the confidential communication." Pet. App. 15.

But, as the court correctly concluded, the factual circumstances of this case are not analogous to those in *Liebman*. In *Liebman*, the IRS affidavit revealed the contents of a privileged communication between the lawyer and the client, which was the specific advice that the fee was deductible. 742 F.2d at 809. In this case, by contrast, only the identity of the clients is at issue—for petitioners have conceded that, aside from the fact that the documents reveal their identities as BDO clients who invested in at least one of the 20 types of tax shelters described in the summonses, the documents contain no otherwise-privileged communications. Pet. App. 5. The present case is thus the standard case described by the court in *Liebman* for which disclosure of client identity is *not* privileged: "[i]f the summons merely requested the names of clients who paid fees, the information would not be protected by the attorney-client privilege." 742 F.2d at 809.

Indeed, it was for precisely this reason that the court of appeals rejected the contention that revealing client identities in the present case would reveal a confidential communication (Pet. App. 16):

> The [Roes] have not established that a confidential communication will be disclosed if their identities are revealed in response to the summonses. Disclosure of the identities of the [Roes] will disclose to the IRS that the [Roes] participated in one of the 20 types of tax shelters described in its summonses. It is less than clear, however, as to what motive, or other confidential communication of tax advice, can be inferred from that information alone. Compared

> to the situations in the *Tillotson* and *Cherney* cases, where the Government already knew much about the substance of the communications between the attorney and his unidentified client, in this case the IRS knows relatively little about the interactions between BDO and the [Roes], the nature of their relationship, or the substance of their conversations.

The decision of the court of appeals in the present case merely applies the same legal principles applied in *Liebman* to the different facts of this case. There is no conflict between these decisions and review by this Court is therefore unwarranted.[2]

2. Another significant distinction between this case and *Liebman* is that the present dispute arises in the context of tax shelter disclosures that have been expressly mandated by Congress. As the court of appeals correctly stated (Pet. App. 16-17 (citations omitted)):

> More fundamentally, the [Roes'] participation in potentially abusive tax shelters is information ordinarily subject to full disclosure under the federal tax

---

[2] The exception to the rule that client identities are not privileged originated from the statement by Wigmore that the privilege applies if disclosing the client's identity would disclose the client's *ultimate* motivation. As the Seventh Circuit stated in *Tillotson*, 350 F.2d at 666:

> The disclosure of the identity of the client in the instant case would lead ultimately to disclosure of the taxpayer's motive for seeking legal advice. That this motive of the taxpayer is subject to the privilege is confirmed by Wigmore wherein he states—'A communication as to . . . the ultimate motive of the litigation, is equally protected with others, so far as any policy of privilege is concerned.' 8 Wigmore, *Evidence*, § 2313, 609.

> law. *See* 26 U.S.C. §§ 6111, 6112. Congress has determined that tax shelters are subject to special scrutiny, and anyone who organizes or sells an interest in tax shelters is required, pursuant to I.R.C. § 6112, to maintain a list identifying each person to whom such an interest was sold. This list-keeping provision precludes the [Roes] from establishing an *expectation of confidentiality* in their communications with BDO, an essential element of the attorney-client privilege and, by extension, the § 7525 privilege. At the time that the [Roes] communicated their interest in participating in tax shelters that BDO organized or sold, the [Roes] should have known that BDO was obligated to disclose the identity of clients engaging in such financial transactions. Because the [Roes] cannot credibly argue that they expected that their participation in such transactions would not be disclosed, they cannot now establish that the documents responsive to the summonses, which do not contain any tax advice, reveal a *confidential* communication.
>
> BDO's affirmative duty to disclose its clients' participation in potentially abusive tax shelters renders the [Roes'] situation easily distinguishable from the limited circumstances in which we have determined that a client's identity was information subject to the attorney-client privilege.

In short, by requiring in Sections 6111 and 6112 that the very disclosures be made that petitioners now seek to prevent, Congress has clearly provided that the

identities of tax shelter purchasers are *not* entitled to confidential treatment under Section 7525 of the Code.[3]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General
EILEEN J. O'CONNOR
Assistant Attorney General
FRANK P. CIHLAR
KENNETH W. ROSENBERG
Attorneys

JANUARY 2004

---

[3] Petitioners are also in error in asserting (Pet. 12-13) that Treasury Regulations specify that the statutory taxpayer-practitioner privilege overrides the disclosure requirements of 26 U.S.C. 6112. The temporary regulation on which petitioners rely (Temp. Treas. Reg. § 301.6112-1T Q&A-17(b)) has been replaced by permanent regulations that clearly specify that taxpayer identities are *not* privileged from the disclosure requirements of Section 6112. 26 C.F.R. 301.6112-1(e)(3)(i), (g)(2)(i); see T.D. 9046, 68 Fed. Reg. 10,161, 10,163 (2003).

APPENDIX

1. Section 6111 of the Internal Revenue Code, 26 U.S.C. 6111, provides:

Registration of tax shelters

(a) Registration

(1) In general

Any tax shelter organizer shall register the tax shelter with the Secretary (in such form and in such manner as the Secretary may prescribe) not later than the day on which the first offering for sale of interests in such tax shelter occurs.

(2) Information included in registration

Any registration under paragraph (1) shall include—

(A) information identifying and describing the tax shelter,

(B) information describing the tax benefits of the tax shelter represented (or to be represented) to investors, and

(C) such other information as the Secretary may prescribe.

(b) Furnishing of tax shelter identification number; inclusion on return

(1) Sellers, etc.

Any person who sells (or otherwise transfers) an interest in a tax shelter shall (at such times and in such manner as the Secretary shall prescribe) furnish to each investor who purchases (or otherwise acquires) an interest in such tax shelter from such

person the identification number assigned by the Secretary to such tax shelter.

(2) Inclusion of number on return

Any person claiming any deduction, credit, or other tax benefit by reason of a tax shelter shall include (in such manner as the Secretary may prescribe) on the return of tax on which such deduction, credit, or other benefit is claimed the identification number assigned by the Secretary to such tax shelter.

(c) Tax shelter

For purposes of this section—

(1) In general.

The term "tax shelter" means any investment—

(A) with respect to which any person could reasonably infer from the representations made, or to be made, in connection with the offering for sale of interests in the investment that the tax shelter ratio for any investor as of the close of any of the first 5 years ending after the date on which such investment is offered for sale may be greater than 2 to 1, and

(B) which is—

(i) required to be registered under a Federal or State law regulating securities,

(ii) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or State agency regulating the offering or sale of securities, or

(iii) a substantial investment.

(2) Tax shelter ratio defined

For purposes of this subsection, the term "tax shelter ratio" means, with respect to any year, the ratio which—

(A) the aggregate amount of the deductions and 350 percent of the credits which are represented to be potentially allowable to any investor under subtitle A for all periods up to (and including) the close of such year, bears to

(B) the investment base as of the close of such year.

(3) Investment base

(A) In general

Except as provided in this paragraph, the term "investment base" means, with respect to any year, the amount of money and the adjusted basis of other property (reduced by any liability to which such other property is subject) contributed by the investor as of the close of such year.

(B) Certain borrowed amounts excluded

For purposes of subparagraph (A), there shall not be taken into account any amount borrowed from any person—

(i) who participated in the organization, sale, or management of the investment, or

(ii) who is a related person (as defined in section 465(b)(3)(C)) to any person described in clause (i),

unless such amount is unconditionally required to be repaid by the investor before the close of the year for which the determination is being made.

(C) Certain other amounts included or excluded

(i) Amounts held in cash equivalents, etc.

No amount shall be taken into account under subparagraph (A) which is to be held in cash equivalent or marketable securities.

(ii) Amounts included or excluded by Secretary

The Secretary may by regulation—

(I) exclude from the investment base any amount described in subparagraph (A), or

(II) include in the investment base any amount not described in subparagraph (A),

if the Secretary determines that such exclusion or inclusion is necessary to carry out the purposes of this section.

(4) Substantial investment

An investment is a substantial investment if—

(A) the aggregate amount which may be offered for sale exceeds $250,000, and

(B) there are expected to be 5 or more investors.

(d) Certain confidential arrangements treated as tax shelters

(1) In general

For purposes of this section, the term "tax shelter" includes any entity, plan, arrangement, or transaction—

(A) a significant purpose of the structure of which is the avoidance or evasion of Federal income tax for a direct or indirect participant which is a corporation,

(B) which is offered to any potential participant under conditions of confidentiality, and

(C) for which the tax shelter promoters may receive fees in excess of $100,000 in the aggregate.

(2) Conditions of confidentiality

For purposes of paragraph (1)(B), an offer is under conditions of confidentiality if—

(A) the potential participant to whom the offer is made (or any other person acting on behalf of such participant) has an understanding or agreement with or for the benefit of any promoter of the tax shelter that such participant (or such other person) will limit disclosure of the tax shelter or any significant tax features of the tax shelter, or

(B) any promoter of the tax shelter—

(i) claims, knows, or has reason to know,

(ii) knows or has reason to know that any other person (other than the potential participant) claims, or

(iii) causes another person to claim,

that the tax shelter (or any aspect thereof) is proprietary to any person other than the potential participant or is otherwise protected from disclosure to or use by others.

For purposes of this subsection, the term "promoter" means any person or any related person (within the meaning of section 267 or 707) who participates in the organization, management, or sale of the tax shelter.

(3) Persons other than promoter required to register in certain cases

(A) In general

If—

(i) the requirements of subsection (a) are not met with respect to any tax shelter (as defined in paragraph (1)) by any tax shelter promoter, and

(ii) no tax shelter promoter is a United States person,

then each United States person who discussed participation in such shelter shall register such shelter under subsection (a).

(B) Exception

Subparagraph (A) shall not apply to a United States person who discussed participation in a tax shelter if—

(i) such person notified the promoter in writing (not later than the close of the 90th day after the day on which such discussions began) that such person would not participate in such shelter, and

(ii) such person does not participate in such shelter.

(4) Offer to participate treated as offer for sale

For purposes of subsections (a) and (b), an offer to participate in a tax shelter (as defined in paragraph (1)) shall be treated as an offer for sale.

(e) Other definitions

For purposes of this section—

(1) Tax shelter organizer

The term "tax shelter organizer" means—

(A) the person principally responsible for organizing the tax shelter,

(B) if the requirements of subsection (a) are not met by a person described in subparagraph (A) at the time prescribed therefor, any other person who participated in the organization of the tax shelter, and

(C) if the requirements of subsection (a) are not met by a person described in subparagraph (A) or (B) at the time prescribed therefor, any person participating in the sale or management of the investment at a time when the tax shelter was not registered under subsection (a).

2. Section 6112 of the Internal Revenue Code, 26 U.S.C. 6112, provides:

Organizers and sellers of potentially abusive tax shelters must keep lists of investors

(a) In general

Any person who—

(1) organizes any potentially abusive tax shelter, or

(2) sells any interest in such a shelter,

shall maintain (in such manner as the Secretary may by regulations prescribe) a list identifying each person who was sold an interest in such shelter and containing such other information as the Secretary may by regulations require.

(b) Potentially abusive tax shelter

For purposes of this section, the term "potentially abusive tax shelter" means—

(1) any tax shelter (as defined in section 6111) with respect to which registration is required under section 6111, and

(2) any entity, investment plan or arrangement, or other plan or arrangement which is of a type which the Secretary determines by regulations as having a potential for tax avoidance or evasion.

(c) Special rules

(1) Availability for inspection; retention of information on list

Any person who is required to maintain a list under subsection (a)—

(A) shall make such list available to the Secretary for inspection upon request by the Secretary, and

(B) except as otherwise provided under regulations prescribed by the Secretary, shall retain any information which is required to be included on such list for 7 years.

(2) Lists which would be required to be maintained by 2 or more persons

The Secretary shall prescribe regulations which provide that, in cases in which 2 or more persons

are required under subsection (a) to maintain the same list (or portion thereof), only 1 person shall be required to maintain such list (or portion).

3. Section 6707 of the Internal Revenue Code, 26 U.S.C. 6707, provides:

Failure to furnish information regarding tax shelters

(a) Failure to register tax shelter

(1) Imposition of penalty

If a person who is required to register a tax shelter under section 6111(a)—

(A) fails to register such tax shelter on or before the date described in section 6111(a)(1), or

(B) files false or incomplete information with the Secretary with respect to such registration,

such person shall pay a penalty with respect to such registration in the amount determined under paragraph (2) or (3), as the case may be. No penalty shall be imposed under the preceding sentence with respect to any failure which is due to reasonable cause.

(2) Amount of penalty

Except as provided in paragraph (3), the penalty imposed under paragraph (1) with respect to any tax shelter shall be an amount equal to the greater of—

(A) 1 percent of the aggregate amount invested in such tax shelter, or

(B) $500.

(3) Confidential arrangements

(A) In general

In the case of a tax shelter (as defined in section 6111(d)), the penalty imposed under paragraph (1) shall be an amount equal to the greater of—

(i) 50 percent of the fees paid to all promoters of the tax shelter with respect to offerings made before the date such shelter is registered under section 6111, or

(ii) $10,000.

Clause (i) shall be applied by substituting "75 percent" for "50 percent" in the case of an intentional failure or act described in paragraph (1).

(B) Special rule for participants required to register shelter

In the case of a person required to register such a tax shelter by reason of section 6111(d)(3)—

(i) such person shall be required to pay the penalty under paragraph (1) only if such person actually participated in such shelter,

(ii) the amount of such penalty shall be determined by taking into account under subparagraph (A)(i) only the fees paid by such person, and

(iii) such penalty shall be in addition to the penalty imposed on any other person for failing to register such shelter.

(b) Failure to furnish tax shelter identification number

(1) Sellers, etc.

Any person who fails to furnish the identification number of a tax shelter which such person is required to furnish under section 6111(b)(1) shall pay a penalty of $100 for each such failure.

(2) Failure to include number on return

Any person who fails to include an identification number on a return on which such number is required to be included under section 6111(b)(2) shall pay a penalty of $250 for each such failure, unless such failure is due to reasonable cause.

4. Section 6708 of the Internal Revenue Code, 26 U.S.C. 6708, provides:

Failure to maintain lists of investors in potentially abusive tax shelters

(a) In general

Any person who fails to meet any requirement imposed by section 6112 shall pay a penalty of $50 for each person with respect to whom there is such a failure, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The maximum penalty imposed under this subsection for any calendar year shall not exceed $100,000.

(b) Penalty in addition to other penalties

The penalty imposed by this section shall be in addition to any other penalty provided by law.

5. Section 7525 of the Internal Revenue Code, 26 U.S.C. 7525, provides:

Confidentiality privileges relating to taxpayer communications

(a) Uniform application to taxpayer communications with federally authorized practitioners

(1) General rule

With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

(2) Limitations

Paragraph (1) may only be asserted in—

(A) any noncriminal tax matter before the Internal Revenue Service; and

(B) any noncriminal tax proceeding in Federal court brought by or against the United States.

(3) Definitions

For purposes of this subsection—

(A) Federally authorized tax practitioner

The term "federally authorized tax practitioner" means any individual who is authorized under Federal law to practice before the Internal Revenue Service if such practice is subject to Federal regulation under section 330 of title 31, United States Code.

(B) Tax advice

The term "tax advice" means advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice described in subparagraph (A).

(b) Section not to apply to communications regarding corporate tax shelters

The privilege under subsection (a) shall not apply to any written communication between a federally authorized tax practitioner and a director, shareholder, officer, or employee, agent, or representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter (as defined in section 6662(d)(2)(C)(iii)).